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Published in:
Research of Accounting of Emerging Economies

IMPORTANT NOTE: You are advised to consult the publisher's version (publisher's PDF) if you wish to cite from it. Please check the document version below.

Document Version
Final author's version (accepted by publisher, after peer review)

Publication date:
2003

[Link to publication in University of Groningen/UMCG research database](#)

Citation for published version (APA):

Hailemariam, S., & von Eije, J. H. (2003). The costs of slow privatization: The case of the beverage and textile industries in Eritrea. *Research of Accounting of Emerging Economies*, 2, 387 - 406.

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Published in:
Default journal

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Document Version
Publisher's PDF, also known as Version of record

Publication date:
2003

[Link to publication in University of Groningen/UMCG research database](#)

Citation for published version (APA):
Hailemariam, S., & Eije, H. V. (2003). The costs of slow privatization: The case of the beverage and textile.
Default journal.

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The Costs of Slow Privatization: the Case of the Beverage and Textile Industries in Eritrea

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Published as: Hailemariam, S. and J.H. von Eije (2003), The Costs of Slow Privatization: The Case of the Beverage and Textile Industries in Eritrea, *Research of Accounting of Emerging Economies*, supplement 2, p. 387- 406.

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Stifanos Hailemariam works at the University of Asmara (Eritrea) and Henk von Eije at the University of Groningen (The Netherlands). This article is a result from a long-term co-operation program between the two universities. The authors like to thank the NUFFIC for its contribution to the research costs and Jos van der Werf for his contribution to the research. They moreover, like to thank Oscar Couwenberg, Caroline Quispel, Sebhat Tewolde, Bob Scapens, Jessica Bakker, two anonymous referees and the editors for their comments on a previous version of this paper. Of course the usual disclaimers remain relevant.

The Costs of Slow Privatization: the Case of the Beverage and Textile Industries in Eritrea

Abstract

In many developing countries the privatization of state-owned enterprises has received increased attention, but the selling of enterprises in developing countries is difficult. This makes it relevant to study accounting and financing aspects during the process of privatization. In Eritrea at the end of 1996 state-owned enterprises were offered for sale, but by June 1999 many of the relatively large companies were not yet privatized. This offered the possibility to evaluate the impact of slow privatization in a developing country. It proved that the slow privatization process gave rise to indirect financial and social costs. After the privatization announcement, the state-owned enterprises in both the profitable beverage industry and the unprofitable textile industry showed a reduction of profitability. Moreover, in both industries the managers complained about the long duration of the privatization process and about a lack of future orientedness and inadequate managerial empowerment.

Key words – Developing countries, Africa, Eritrea, privatization, profitability, internal financing, beverage industry, textile industry, slow privatization costs.

1. Introduction

The concept of privatization can have various meanings [Starr, 1988], but if applied to developing countries the word "privatization" generally implies a shift of ownership of companies from the state to the private sector. The intended shift of ownership stems from a multitude of reasons [United Nations, 1996; Megginson and Netter, 2000], but two major general economic reasons are the endeavor to create a more efficient economy as well as the need to alleviate governmental budgetary problems. Privatization is therefore frequently propagated when bad economic conditions, high foreign debt, high dependence on international agencies and budget deficits prevail [Ariyo and Jerome, 1999; Ramamurti, 1992; Yarrow, 1999]. These economic circumstances may thus make privatization urgent and some authors propagate a fast privatization of state-owned enterprises [Boycko, Shleifer and Vishny, 1996; Donaldson and Wagle, 1995; Bennell, 1997]. Other authors, however, propagate a gradual approach to privatization, because the gain from hasty privatization should be compared with the social costs of speed [Aghion and Blanchard, 1994; Katz and Owen, 1995] and because a speedy privatization can result in poorly conceived privatization schemes [Ramamurti, 1999].

In general, urgency is high in developing countries, and many of these countries started privatization programs. However, a weak regulatory framework, an ineffective private sector, a low level of domestic savings and the absence of an adequate stock market diminish the ease of privatization in these countries [Ariyo and Jerome, 1999]. Urgency, moreover, does not attract investors. Potential buyers only consider purchasing unprofitable companies if they are allowed to restructure them and to lay-off workers. Governments, at the other hand, hesitate to give carte blanche to a buyer, because asset stripping reduces the value of the company to the country and the firing of employees generates unemployment. Sometimes even profitable companies cannot be sold fast because governments do not like to sell profitable companies at low prices and the search for the highest bidder may take time.

In Eritrea the aforementioned conflicts of interest between potential buyers and the government slowed the pace of privatization and both profitable and unprofitable companies listed for

privatization became stuck in a long-term privatization period. The lack of privatization success, however, made it possible to study accounting and financing aspects of companies during the process of privatization. Because slow privatization is not yet studied in depth at the level of the firm one may learn what is relevant for a company during a long privatization period in a developing country.

The case of Eritrea is also interesting, because both profitable as well as unprofitable companies were offered for sale. As is well known, the internal financing and the reallocation of money across subsidiaries of conglomerates may have benefits [Stein, 1997]. Though these benefits can be discussed in developed countries [Scharfstein, 1998; Shin and Stulz, 1996; Rajan, Servaes and Zingales, 2000], it is likely that they are relevant when financial markets are less than perfect and when management potential is scarce [Baker, 1992; Brealey and Myers, 2000, p. 986 ff.]. As this is the case in developing countries, it implies that at least some companies there (and in particular the unprofitable ones) may benefit from being a member of a government conglomerate. However, privatization threatens to split the conglomerate and it may then be interesting to see whether or not the long privatization process is condemned in profitable companies and welcomed in loss making companies.

This article highlights the Eritrean privatization policy and the direct privatization results in section 2. Then it presents the methodology and data in section 3. Section 4 compares the developments for state-owned and private enterprises as well as the development of profitability in both the beverage and the textile industry before and after the announcement of privatization. Section 5 gives the reactions of company managers on privatization. In section 6 we relate our findings to the theory of privatization and to accountability and internal financing. Section 7 summarizes the findings and concludes the paper.

2. Privatization in Eritrea

Prior to 1975, Eritrea was a relatively small province of Ethiopia with an industrial sector founded during the previous Italian occupation that accounted for a relative large percentage of the industrial

output of Ethiopia [GOE, 1994, p.4]. In 1975, the Marxist government of Ethiopia adopted a command economic system and nationalized large manufacturing enterprises. During the period 1975-1991 that government neglected the factories and drained their resources. When in 1991 Eritrea became an independent country, the new government adopted a free market policy to resuscitate the economy.

The government of Eritrea began to sell small co-operative shops in 1992 and returned nationalized houses and other buildings to their former owners. In 1995 the Eritrean government established the National Agency for the Supervision and Privatization of Public Enterprises (NASPPE) to reduce the number of public enterprises. The objectives of NASPPE are to privatize public enterprises and to implement appropriate management policies in order to vitalize productivity and to establish a competitive and conducive economic ambience in all public enterprises [GOE, 1995, p.4]. At the end of 1996, the NASPPE announced that 39 of the 42 publicly owned manufacturing enterprises should be privatized. Moreover, one of the formerly nationalized companies was liquidated, while two were not offered for sale because the government considered them as strategic.

The NASPPE has been using a direct sales method. Usually, companies are advertised in local as well as international newspapers such as The Economist. Enterprises are auctioned and investors bid for the companies. The NASPPE evaluates the price offered and the business plans of investors regarding investments, technology transfer and job creation and then makes its decision.

Table 1 shows the companies sold in each sector as well as the number of enterprises owned by the state in June 1999 and some of the company characteristics.

Table 1 about here

Table 1 shows the direct consequences for the sale of 18 companies until June 1999. In these companies 1,681 employees (22%) were employed, while 5,797 employees (78%) were with companies still to be privatized. The Eritrean government raised 156.2 million Nakfa from the sales of the enterprises (1 Nakfa may be equaled to 0.14 US dollar). 52.7 million Nakfa (34% of the total

value) was received from the sale of Gash Cigarette Factory. The other 17 companies were sold for a total of 103.5 million Nakfa.

Table 1 also indicates that the enterprises sold are relatively small and that larger manufacturing companies are still owned by the state. The metal and wood products industry and the chemical industry (soap factories) were privatizing fast. Food, textiles, leather and shoe and non-metallic minerals (cement and salt) companies were less easily privatized. In fact, some of these companies were already offered for sale three or four times but are not sold yet. This is either due to the fact that they did not attract investors or that the government did not accept the bid price and/or the business plan.

3. Methodology and data

As far as we know, until now no in-depth study of the impact of slow privatization is available. Our insights are therefore inductively derived from systematic data collection and the analysis of these data. This approach may be characterized as using grounded theory [Glaser and Strauss, 1967], where data collection, analysis, and theory stand in reciprocal relationship with each other. When using grounded theory, researchers do not begin with a theory and subsequently prove it; rather they begin with an area of study, after which the relevant points of that area are allowed to emerge.

Within this emerging framework, “reality” may be approached in various ways. Burrell and Morgan [1979] developed a classification of social research based on two dichotomies, namely on the nature of knowledge (objective or subjective) and on the way knowledge is used. If the knowledge is to be used for radical change, they speak of the radical humanist paradigm (if knowledge is subjective) or of the radical structuralist paradigm (if knowledge is objective). If knowledge is developed for regulating society, e.g. for control and not for radical change, they distinguish an interpretive (subjective) and functionalist (objective) paradigm. Within this classification, we take an interpretative approach. This means that we believe that the social world can gradually be changed and that it can be understood from the point of view of the individuals who are directly involved in the

activities which are being studied. This brings us to the qualitative research method, which is relevant in helping researchers to understand people and the social contexts in which they live. This does not mean that we dismiss the use of quantitative data. In our opinion quantitative data are also relevant for understanding the world and, moreover, even such data may be considered to be "social constructs" that are meant to improve communication between various individuals and groups, like for example financial accounting data.

In order to study the effects of a long privatization period on profitability, we made use of both qualitative and quantitative data and we followed a top-down triangulation approach. This approach, which is extensively documented in Hailemariam [2001], used macro-economic data, company data, questionnaires as well as documented interviews with the relevant managers.

First, we present the macro-economic developments before and after the announcement of privatization in public and private companies. Because we also wanted to learn whether profitable and unprofitable companies reacted differently during a protracted privatization period, we compared companies in a profitable industry with those in an unprofitable industry. We searched for industries that embraced at least three companies facing a long duration of the privatization process, and among these we looked for the industry with the highest profits and the one with the largest losses. These proved to be the beverage industry and the textile industry respectively. This approach made it possible to study whether the long duration of the privatization process has affected the individual companies as well as the classes of both profitable and loss generating companies in the same way.

With respect to the financial statement data we considered the possibility that the increasing trouble with the neighboring country of Ethiopia might contaminate the measurements of the impact of the privatization announcement. Because, previously, many companies exported to Ethiopia, we studied whether the problem of export reduction affected the financial statements in these two industries after the privatization announcement. It proved that the exports of the beverage industry were irrelevant and that this industry was hardly influenced by the stressed situation between the two countries. The textile industry, however, was to a large extent affected negatively by the difficulties, but the main problem, namely the reduction of exports to Ethiopia, were already visible in the annual accounts in the years before the textile companies were slated for privatization. In fact, the

disappearance of export possibilities contributed to a large extent to the losses in the textile industry in the years 1995 and 1996. Therefore, the data of the textile industry show the influence of the conflict in the years before as well as during the period after the privatization announcement. This implies, however, that the major changes in the annual accounts of the textile industry after the privatization announcement cannot be attributed to the crisis with Ethiopia.

We intended to study all companies due to be privatized in the beverage industry as well as in the textile industry. However, in comparison to Table 1, the fourth state-owned company from the textile industry was left out of the sample, because its auctioning was in progress during the period of the fieldwork. Therefore, we analyzed the three remaining companies in the textile industry and the three from the beverage industry that were not yet privatized during the period of the fieldwork from January 1998 till October 1998. As can be seen from Table 1, one company from the beverage industry was, however, privatized somewhat later.

After the macro-economic analysis and the comparison of the developments in the financial statements of the six individual companies slated for privatization, we tried to verify the findings with the opinions of individual managers. In the privatization literature opinions of individual managers are often neglected. This may be caused by the fact that managers are considered as agents of the state. If the state wants to sell a company, the incumbent managers may be irrelevant for the future of the company, because they will have a large chance of being dismissed when the company is sold. Nevertheless, if privatization takes a long period of time, the incumbent managers are relevant for the company during the bridging period. Moreover, an analysis of annual accounts gives some information on why profits are generated or losses occur, but the tendency from financial accounts can be further illuminated and explained with information gathered from inside managers. Finally, potential purchasers normally use future oriented business evaluations [Bennell, 1997, p. 1799] besides information from the annual accounts. Though accounting information is very relevant for developing countries [Seiler, 1966], annual accounts are illuminations from the past. They are not future oriented and do not indicate how revenue could be increased and cost reduced: it may often even be necessary to increase outlays in order to generate more sales, e.g. for marketing or for attracting highly qualified personnel. For these reasons the elicitation of management knowledge may

be more informative than gathering solely information from annual accounts [Earle, Estrin and Leshchenko, 1996].

Therefore, management opinions were collected. We used questionnaires and open interviews. The information from the questionnaires aimed at acquiring background information and will not be extensively reported upon here. The open interviews were aimed at the general, financial, production and marketing managers of the six companies. The managers interviewed were asked what efforts were made to improve company sales and reduce costs, what constraints were encountered, what further plans they had regarding increasing sales or reducing costs, and how the privatization policy was influencing company operations.

From each of the six companies we tried to interview all four types of managers. Therefore 24 managers formed the target population. However, one general manager of the beverage industry did not participate because of a busy work schedule and one marketing position in the textile industry was vacant. For these reasons 22 managers were participating in the research. The interviews took place at the respondents' offices. On average the duration of the interviews was 67 minutes for the general managers, 64 minutes for the financial managers, 59 minutes for the production managers and 40 minutes for the marketing managers. During the interviews notes were taken and interviews taped if that did not inconvenience the managers. The interviewees responded in the local language (Tigrigna) and after the interview the researcher transcribed the interviews in English the same day. The managers interviewed were generally very co-operative. This may partly be the result of the fact that they were managing state-owned enterprises, and that it is customary for these Eritrean managers to help researchers from the University of Asmara.

After having finished the fieldwork, the research on the beverage and textile industry was described in separate chapters. Together with information on two other industries these results were condensed in another chapter and concluded upon in a PhD [Hailemariam, 2001]. The results of this paper are based on that PhD and both publications do share the main general outcome. However, this paper adds a new focus by comparing companies from a profitable with those of a loss-making industry and by relating the outcomes to financing and accounting aspects.

4. Changes in sales and profitability

The direct privatization revenues presented in Table 1 do not present a complete picture of the financial consequences of privatization to the government. According to Donaldson and Wagle [1995, p. 36] 'Enterprises are living things, and deteriorate very quickly once they are "for sale". It is imperative, therefore, not only to complete divestitures as quickly as possible, but also to manage the business well in the interim. While a firm is for sale, key employees doubt the firm's commitment to them, are less motivated, are attracted to alternative employment...(and the) selling process is a distraction to management, which is tempted to leave critical matters unattended because they assume a new owner will take them in hand.' If Donaldson and Wagle are correct, we might find negative effects of the privatization announcement in the annual accounts of the remaining public companies in 1997 and 1998 (see Table 2).

Table 2 about here

According to Table 2 the operating profit of all Eritrean companies with more than 10 employees declined from 1996 to 1997 from 253 million Nakfa to 163 million Nakfa. It is likely that the reduction in operating profit can be attributed to the state-owned enterprises. According to Table 2, the previously increasing trend in value added at factor costs was reversed in public companies. Their value declined from 315 million Nakfa in 1996 to 270 million Nakfa in 1997, while in the same period the value added with private companies increased from 37 million Nakfa to 103 million Nakfa. Until now we can, however, not be sure whether these negative effects depend upon the companies slated for privatization and upon the companies remaining under government governance. Moreover, it is not yet clear whether the negative effects will only be found in profitable or also in unprofitable public companies. Table 3, therefore, gives additional information on the sales of the companies to be privatized in the two industries for the period 1992-1998.

Table 3 about here

Table 3 shows that in the year after the privatization announcement the sales of all six companies studied declined. Moreover, while in most companies there was a clear upward trend until 1996, this trend reversed in 1997. In four companies the situation deteriorated even further in 1998 and the aggregate sales in both the beverage industry and the textile industry declined during two consecutive years. The decline, however, was smaller in the beverage industry than in the textile industry. In comparison to the highest amount of sales in 1996 the sales in the profitable beverage industry declined with 12% in the first year after the privatization announcement, and with 2% the year thereafter. These percentages were respectively 20 and 24 for the loss-making textile industry. The latter figure suggests that the long term effect of slow privatization may be worse in unprofitable industries, but such a conclusion does not hold if we consider company profits (see Table 4).

Table 4 about here

Table 4 shows that all beverage companies were profitable in 1996 and in 1997, while all companies in the textile industry showed a loss in the same period. In the year after the privatization announcement company 2 showed a small increase in profits and company 4 reduced its losses, but the profitability in the other four companies declined. During a protracted privatization period the textile industry losses reduced in 1998 in comparison to 1997, while the profits of the beverage industry declined further in 1998.

Though the effects for companies and industries varied, information taken from both 1997 and 1998 suggests that the profitable beverage industry as well as the loss-making textile industry were affected by a major shock. As indicated in section 3, when comparing 1996 with 1997 (and 1998), it is not likely that the stressed relationship with Ethiopia was responsible for the changes in the financial statements. Because we are not aware of other major factors that could have influenced the financial statements of the companies, the financial changes after the privatization announcement

might be attributed to this announcement. Nevertheless, also a combination of minor factors might significantly influence the financial performance of a company. Because minor changes may affect various companies in different ways and all six companies were affected negatively, it is more likely that one major structural break occurring at the end of 1996 caused the observed similar decline in performance. Though it is thus presumable that the privatization announcement caused the structural break, one can, however, never be certain that no other combination of factors is accountable for the worsening of the financial performance. For that reason it may also be worthwhile to corroborate the financial data with interviews with various types of managers from the separate companies.

5. Managers on privatization

We interviewed managers of the profitable and the loss-making firms in order to learn what privatization meant for their company. Despite the differences in profitability, managers from both industries were united in two respects with regard to privatization. Firstly, the managers did not complain about the fact that their company was slated for privatization. In general they supported the idea that privatization is good for the company and the country. Secondly, managers from both industries complained about the slow speed of privatization. In this sense, the qualitative interviews with the managers also indicate the reasons for the negative quantitative developments in the annual accounts after the privatization announcement. In particular, we found disengagement and a loss of future orientedness within the companies.

The disengaging attitude of the employees and the managers due to the slow pace of privatization was phrased by the production manager of the Asmara Wine and Liquor Factory in the following way: *"People have become disinterested due to privatization. They say the factory will be sold. So there is no need for working hard or for future planning.... The enterprises management team used to meet monthly but now -since we heard that the company is to be privatized- we never meet".* Privatization diminished the orientation on the future too and the marketing manager of the Asmara Wine and Liquor Factory phrased the influence of privatization on company operations as follows:

"Privatization does not help in future planning. Also the people do not work on full mentality and they do not have any vision at the moment because their future is not secure."

Despite agreement upon the merits of privatization and unity in condemning the slow pace of privatization, there were also differences between the managers from the two types of industry. The different (profitability) backgrounds of the companies caused differences in reference frames and focus during the protracted privatization process. For example, managers in the profitable beverage industry do see potential for direct improvements, while the managers of the textile industry only see a future for the company if it will be privatized. The general manager of the Asmara Brewery said: *"In 1995 we started a renovation project, but the NASPPE has stopped us from enacting the second phase on the ground that -if the factory is to be sold- we should leave it to the new buyer to choose any kind of investment..."*. The production manager of the Eritrean Textile Factory at the other hand assumed that his company should be privatized before innovation could take place: *"We expect to privatize the company and hope that this will bring new technology"*. In fact the textile industry may even expect a financial impulse from the new owner as phrased by the financial manager of the Eritrea Textile Factory *"The delay of privatization is aggravating the financial problem of the company. ... Had there been an ownership change, the new buyer would have injected new finances..."*

Moreover, the managers in the beverage industry were more oriented to investments, while the managers of the textile industry were struggling for survival by reducing costs. This gave a different focus to their ideas about where to look for improvements. For example, the marketing manager of the Asmara Wine and Liquor Factory stated: *"We had a plan to introduce automatic machines and to improve sales but due to privatization we do not have any plans"*, while the general manager of the Eritrea Textile Factory at the other hand said: *"If the company would be privatized, the new owner could reduce costs by self financing the company and this would enable the company to become competitive in the market"*. In fact the managers of the textile industry may not even dare to think about proposing investments to the NASPPE. The general manager of the Eritrea Textile Factory, for example, said: *"If we want to invest in fixed assets, we have to present our proposal to the NASPPE. But due to the losses that we have they will not approve any new fixed asset investment"*.

In the beverage industry the managers not only complained about the restrictions imposed on investing in fixed assets, but the NASPPE also restricted the amount of inventory. Companies were allowed to buy stocks needed for three months only. This guideline did not affect local purchases, but it created a problem for foreign purchases. Quite some companies had been buying stocks from foreign countries on a six months basis because it takes a very long time until deliverance. The curtailing of stock thus inconvenienced the normal operations of companies. The general manager of the Asmara Brewery for example said: *"When our factory was offered for privatization, we were not allowed to keep a large amount of stock ... in order to minimize the burden on the buyer. This restriction increases our ordering costs and since our factory requires a large amount of malt, it creates a problem."*

The differences in profitability reference frame and focus thus resulted in different complaints about the slow pace of privatization. The managers from the beverage industry complained about the restrictions of the NASPPE, while the managers from the textile industry complained about the long duration itself. Where the general manager of the Asmara Brewery said *"Privatization has been the main constraint in upgrading machinery. The Board of the NASPPE does not allow long-term investments in machinery"*, the marketing manager of the Eritrean Textile factory said: *"To solve the problems that the company is facing, the privatization process should be accelerated"*.

Because within grounded theory "actors own words and interpretations are necessary, respected, but recast in new and analytic terms" [Strauss and Corbin, 1997, p. 64], researchers who follow this approach do generally not question the truthfulness of the respondents. We, however, think that there are additional arguments making us believe that the managers responded faithfully. Firstly, there is a general policy within Eritrea that managers of state-owned enterprises should give researchers of the University of Asmara the information they are asking for. Secondly, according to the agency theory based on Jensen and Meckling [1976], self interested managers may bring costs to the owners of companies. In the privatization context, one might then expect that managers oppose to privatization because they want to keep their job as long as possible. Managers would then emphasize the benefits of not being privatized. In the Eritrean case, however, the managers were complaining about the long privatization process and none of the respondents indicated that the slow process of

privatization was in any way beneficial. When considering agency costs these answers were unexpected, but we discovered that they might be explained by the fact that Eritrean managers of state-owned enterprises do not have to fear privatization: managers retain a government job after having to leave their privatized company.

However, one might then suggest that self-interested managers will -at least verbally- adhere to the government policy in order not to endanger their future in a government job. Verbal conformism with the government from the side of the managers is, however, neither very likely if one considers the fact that the managers are critical about the functioning of the government related privatization agency (NASPPE). Of course, one should then also consider the possibility that managers may not like to blame themselves and that they look for an outside institution -like the NASPPE- to reproach. However, an interview with the (part-time) director of the NASPPE revealed that in fact the NASPPE did not have the resources to adequately guide and manage the privatization process. Finally, frankness of opinion may also come from previous experiences of the managers. This is likely because most of the managers have been freedom fighters who were used to present their own arguments in an open exchange of thoughts. For these reasons, we think that the responses of the managers are not biased.

On the basis of the management interviews we therefore conclude that the decline in performance goes hand in hand with the long duration of the privatization of the individual companies. In this sense the managers corroborate the findings from the annual accounts shown in Tables 3 and 4. Moreover, the information of the managers goes deeper, because it shows that it is not the long duration itself, but the increasing disengagement and the lack of clarity and future orientedness that worsen the performance of the companies during the protracted privatization period. The interviews also identified differences between profitable and unprofitable companies. Managers of the companies in the beverage industry did see profitable opportunities that were frustrated by the privatization authority. They therefore complained about a lack of empowerment to invest. The managers of the loss-making companies in the textile industry, at the other hand, did not envisage clear prospects in the short run. This was not strange, because a long time before the privatization announcement the textile industry had already been confronted with a lack of demand, high costs, a

lack of experience and a lack of flexibility. Nevertheless, the managers of the textile industry were under the impression that when the company would be privatized, the new owner could provide new financing and new technology. In that utopian situation their company might have possibilities to generate profits. In the meantime, they try to survive by reducing the costs.

6. Indirect, social and hidden privatization costs

With respect to grounded theory, it is worthwhile to relate the empirical findings to the literature. Our findings suggest that the process of privatization itself can endanger profitability and it confirms the idea of Ramamurti [1999] that privatization schemes should be well prepared. In particular, if privatization has to reduce government budget deficits, one should not only take into account the direct cash revenues of selling companies, but also the negative impact of a long privatization period. This conclusion is relevant for profitable as well as unprofitable companies in Eritrea. This result suggests that authors that propagate fast privatization of state-owned enterprises [Boycko, Shleifer and Vishny, 1996; Donaldson and Wagle, 1995; Bennell, 1997] may be correct. Companies in Eritrea did financially deteriorate after the privatization announcement, and governments do wise to take into account potential indirect privatization losses during a potential protracted privatization period.

Moreover, authors that propagate a gradual approach to privatization because of the social (unemployment) costs of speed [Aghion and Blanchard, 1994; Katz and Owen, 1995], may neglect the social costs of a prolonged privatization period. The interviews with various types of managers in different Eritrean companies revealed that slow privatization caused social costs within companies. These social costs can be labeled as "disengagement" and are likely caused by the absence of a clear perception of the future from the part of the individual participants. When Crum and Goldberg [1998, p. 7] say that almost "every action taken by the company management is noted in the accounting system", we may argue that the financial deterioration of the Eritrean companies may be caused by the *absence of actions* of managers resulting from an inadequate empowerment offered to them by the privatization authority. When governments want companies to remain viable during a long

privatization period, the authority and accountability of the managers of the privatizing firms should be taken care of.

The lack of managerial influence may also have contributed to the enthusiasm of the managers for privatization. This was not really expected, because the literature suggests that internal financing and the reallocation of money across subsidiaries of conglomerates may have benefits in developing countries when financial markets are less than perfect and when management potential is scarce [Baker, 1992; Brealey and Myers, 2000, p. 986 ff.]. It implies that privatization may have hidden costs caused by the splitting-up of the conglomerate. In particular the fact that even managers of loss making government companies hailed privatization was unexpected, because after privatization their company will not be further subsidized by the tax payers or the profitable companies. Our findings imply that cross-subsidization is not a major issue to these managers. We therefore come to the conclusion that to the managers of both profitable and unprofitable companies in Eritrea the benefits of being freed from government interference are outweighing the hidden privatization costs of splitting the conglomerate.

7. Summary and conclusions

Privatization in developing countries is a hot issue. It is assumed to improve the economic efficiency of the country and reduce government expenditure on unprofitable companies. Moreover, even profitable companies may be offered for sale for governmental cash-purposes. However, the more a country is in need of privatization, the more difficult actual privatization may be. Eritrea is no exception. Its government openly adopted privatization as a part of a liberalization policy and at the end of 1996 39 companies were slated for privatization. However, mainly small companies were sold, and most large industrial companies remained under state authority. This offered the opportunity to investigate the effects of a long duration of privatization. We studied these effects by consulting financial statements of individual companies and interviewing their managers.

The unprofitable Eritrean textile industry has had problems with demand, costs, experience and flexibility, so the question can be raised whether new management can actually make these companies viable. It is therefore not strange that the privatizing of these companies was difficult. At the other hand, it should not have been hard to sell the profitable beverage companies, where the aforementioned problems were much smaller or non-existent. However, the privatization of the profitable beverage companies also took time. After the privatization announcement, profitability declined in the beverage as well as in the textile companies, and in both industries managers complained about the slow privatization process. Their complaints were not based on a disliking of privatization in general, but on their interest in the growth and survival of their company. This genuine interest was frustrated, because the protracted selling period created indirect costs in the form of reduced profitability and social costs of uncertainty, disengagement and a lack of orientation to the future. The possibility of a decline in profitability of firms during a protracted privatization period should thus be taken care of by governments and it means that managers should be given decision power and be made accountable for their (lack of) actions.

Besides these content conclusions we also have a methodological conclusion. Combining financial statements with qualitative interviews with managers is not the regular way of studying privatization, but it proved to be very valuable. When asking the managers about their experiences with privatization, they propagated the idea that their company should be privatized. This unexpected result could be explained by the fact that they saw the performance of their companies deteriorating and this made them critical of the long duration of this process. In that sense they identified the reasons for the deterioration of the financial statements and thereby corroborated the idea that the financial decline could be attributed to the privatization process.

Moreover, the interviews with the managers gave additional insights into the question why the long duration of the privatization process influenced the performance of their company negatively. The interviews revealed similarities amongst the industries regarding the disengagement and lack of future orientedness, but they also disclosed differences between the two industries. Where the managers of the beverage industry saw investment opportunities that were restricted by the

privatization authorities, the managers of the textile industry were trying to survive in the hope of getting outside financing after privatization.

This brings us to the final benefit of interviewing managers. Without the interviews it would have been impossible to gain knowledge about their expectations and hopes. It was proved that they assume that outside investors do not only pay cash to the government. According to the managers new owners may also bring additional financial resources into the company and -most relevant- the new owners will try to improve profitability and this means that they will foster (new) authorities, trust and an orientation to the future. To the managers these benefits really outweighed any disadvantages arising from their company being split from the government conglomerate.

There are, however, also limitations in our research. Firstly, our sample aimed at studying the impact of slow privatization and therefore did not involve companies that were privatized in a short period of time. Therefore, we do not know whether the fast privatizing companies were faced with the same or with different problems. Secondly, our sample only refers to the Eritrean situation. In Eritrea all relevant companies were offered for privatization simultaneously. Therefore, we cannot compare such a "big bang" to a situation where companies are gradually offered for sale. Though our results show that there may be benefits in fast privatizing after the privatization announcement, we do not know whether companies that are not offered for sale, because according to the gradual approach they are not "ready" to be sold, perform better. Thirdly, we did not study the reasons for the slow privatization process, and it may be possible that the increasing difficulties regarding Ethiopia have deterred foreign investors to buy companies in Eritrea. In more favorable situations the offering of a batch of companies might not be subjected to the same delays of selling, and with the same amount of deterioration. Finally, we should consider the special Eritrean institutional context. In particular the privatization authority (NASPPE) can be characterized as being weak. The lack of capability within - and real authority of- the NASPPE may also have contributed to the lack of adequate investments in profitable companies. If a privatization authority is skilled enough to handle the privatization process more decisively, the degeneration of the profitable companies might at least be less than we found in the Eritrean situation.

Considering these limitations, it is impossible to extend our findings outside our sample and therefore it may be relevant to suggest follow-up research. Our results suggest that slow privatization of individual companies reduces their financial and social capital. It would be interesting to know whether these observations also pertain to other developing countries. It might then be worthwhile to study not only countries that follow the "big bang" approach to privatization, but also countries that use a gradual approach. In particular the performance of companies that remain in the realm of the government can then be compared to those that are slated for privatization. It would, moreover, also be worthwhile to distinguish developing countries with a weak and a strong (if any) privatization authority. In addition, it seems relevant to try to quantify the loss of financial and (if possible also social) capital over time and to relate it to the duration of the privatization period of the individual companies. It would also be interesting to learn what slow to privatize companies will ultimately be privatized, and whether these are either only the profitable companies or both the profitable and unprofitable companies. Finally, it would be worthwhile to study whether any of these privatized companies are able to climb out of the abyss created during the long privatization process in their own or that they will fail or merge into a private conglomerate.

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Table 1. Number of companies sold and unsold (administered by the Ministry of Industry and Trade), the number of employees involved and the revenues of selling the companies in various industries in Eritrea (June 1999)

Sector	Number of companies sold	Number of employees involved	Revenues (mln. Nakfa)	Number of companies not sold	Number of employees in unsold companies
Foods	1	62	5	5	849
Beverages	1	47	8.8	2	627
Tobacco & Matches	1	136	52.7	1	104
Textiles & Fibre	2	731	15.2	4	2,544
Leather & Shoe	1	121	5.4	4	964
Metal & Wood Products	8	365	36.4	2	109
Non-metallic Minerals	-	-		3	600
Chemicals	4	219	32.7	-	-
Total	18	1,681	156.2	21	5,797

Source: information received on request from the NASPPE

Table 2. Operating profit of all companies and value added at factor costs in public and private companies, Eritrea, 1992-1997 (*1000 Nakfa at current prices)

Year	All companies	All companies		Public companies ^{a)}		Private companies	
	Operating profit	#	Value added	#	Value added	#	Value added
1992	110,733	116	158,866	44	141,681	72	17,185
1993	109,652	121	181,249	45	168,934	76	12,315
1994	106,052	131	184,766	46	163,475	85	21,291
1995	217,477	138	302,137	46	278,010	92	24,127
1996	253,438	157	352,087	46	315,212	111	36,875
1997	163,321	205	373,333	46	270,227	159	103,106

Source, State of Eritrea Ministry of Trade and Industry, *Report on Census of Manufacturing Establishments 1992-1997*, Asmara, November 1998, p. 11, 13 and 14.

^{a)} The number of public companies (46) differs from the number of companies in Table 1 (39), because two companies included in this Table are administrated by the Ministry of Agriculture and two by the Ministry of Information (and not the Ministry of Industry and Trade). Moreover, Table 1 does not take into account one company liquidated before June 1999 and two companies that were not offered for sale.

Table 3. Sales of the companies investigated in the period 1992 - 1998.

Company #	Beverage industry					Textile industry		
	1	2	3	Total	4	5	6	Total
Year	Amounts (*1000 Nakfa)							
1992*	25,005	1,234	4,503	30,742	8,561	2,440	2,162	13,163
1993	56,719	1,772	16,606	75,097	12,226	2,502	9,290	24,018
1994	62,769	2,289	20,897	85,955	26,221	9,289	9,381	44,891
1995	125,552	3,153	24,786	153,491	37,541	6,430	6,430	50,401
1996	148,572	4,482	27,751	180,805	39,430	10,232	8,999	58,661
1997	130,764	4,355	24,680	159,799	35,651	6,862	4,322	46,835
1998	131,046	1,809	23,686	156,541	27,482	1,890	6,436	35,808

*For the 1.5 accounting year period 1991/92 we calculated the results on a yearly basis

Source: annual accounts received on request from the companies

The company numbers refer to respectively: 1 = Asmara Brewery, 2 = Asmara Wine and Liquor Factory, 3 = Red See Bottlers, 4 = Asmara Textile Factory, 5 = Eritrea Textile Factory and 6 = Lalmba Sack Factory

Table 4. Operating results of the companies investigated in the period 1992 - 1998.

Company #	Beverage industry				Textile industry			
	1	2	3	Total	4	5	6	Total
Year	Amounts (*1000 Nakfa)							
1992*	13,703	108	1,834	15,654	773	-81	-390	302
1993	31,364	315	7,306	38,985	-5,245	-2,961	3,268	-4,938
1994	36,134	567	9,117	45,818	-9,524	-938	370	-10,092
1995	68,655	1,226	10,329	80,210	-4,943	-2,932	783	-7,092
1996	73,876	1,765	10,168	85,809	-2,354	-550	-336	-3,240
1997	56,305	1,813	7,856	65,974	-1,801	-2,597	-657	-5,055
1998	45,929	454	5,259	51,642	-4,339	-1,084	868	-4,555

*For the 1.5 accounting year period 1991/92 we calculated the results on a yearly basis

Source: annual accounts received on request from the companies

The company numbers refer to respectively: 1 = Asmara Brewery, 2 = Asmara Wine and Liquor Factory, 3 = Red See Bottlers, 4 = Asmara Textile Factory, 5 = Eritrea Textile Factory and 6 = Lalmba Sack Factory